Economic Commentary

TrustINdiana

Market Commentary for **December 2009**

Economy Slowly Recovering as 2009 Ends

Indicators for the U.S. economy were by and large positive for the months of December and November. Although Gross Domestic Product (GDP) growth for the third quarter of the year was once again revised downwardly in the Bureau of Economic Analysis's third and final estimate to 2.2 percent growth from 2.8 percent, the consensus projection for the fourth quarter of 2009 is that growth will be between 3.1 and 3.9 percent. Growth in 2010 is expected to be modestly positive with the potential for upward acceleration if the global recovery continues.

The official unemployment rate for December was 10 percent, unchanged from the previous month. If a broader measure is used, which includes the underemployed and those who have stopped looking for work, the joblessness rate is more than 17 percent. Indeed labor force participation fell in December to 64.6 percent from 64.9 percent in November. It is thought that high unemployment will persist for some time and the rate will not come back to its pre-recession level until perhaps as late as 2013.

Consumer-related economic indicators were largely positive in the preceding two months. The Conference Board index of consumer confidence increased a healthy 2.3 points to 52.9 in December. The rise was led by the future expectations component of the index, while the present conditions part fell 1.4 points. The University of Michigan consumer sentiment index also rose in the same month from to 72.5 from 67.4 in November. Interestingly, in this index the rise was led by current conditions, which jumped nearly 10 points, although expectations also rose. The increases in both indices is rather surprising given consumer fundamentals are still weak and unemployment is high. It must be noted, however, that despite the recent increases in consumer sentiment, it is still low overall on a historical basis.

Personal income increased by 0.4 percent in November, which marks the highest rise since May. Wage income rose 0.3 percent and real spending increased 0.2 percent from the previous month. The saving rate remained essentially flat at 4.7 percent in November. The core personal consumption expenditures (PCE) deflator, which excludes food and energy prices and is the Fed's preferred measure of inflation, remained unchanged in November from the previous month and is up just 1.4 percent from a year ago. These indicators suggest that income and spending have been slowly but more or less steadily increasing since mid-year while at the same time inflation is under control. The core consumer price index (CPI) remained unchanged from October to November. Aside from energy prices, which are up 8 percent year-over-year, prices are not expected to rise in the near term.

Leading business indicators were also mostly positive in November and December. Retail sales increased 1.3 percent in November from the previous month. The jump was led largely by gas sales. New orders for manufactured durable goods rose 0.2 percent in November and are down 6 percent year-over-year. The increase would have been greater but transportation items, such as aircraft and parts, acted as a drag on orders. Excluding this transportation component, durable goods orders increased by 2 percent. The Institute for Supply Management's (ISM) manufacturing index, which measures the overall health of the U.S. manufacturing sector, increased in December 2.3 points to 55.9, making up for November's decline. Any figure above 50 means the sector is in expansionary territory. Manufacturing appears to be on a steady road to recovery.

There was good and bad news for the housing market. Sales of existing homes jumped 7.4 percent in November from the previous month, which followed a 10.1 percent surge in October. This recent activity can be mainly attributed to the first-time homebuyer's tax credit, which has recently been extended to include everyone, not just first-time buyers. On a year-over-year basis sales are up by roughly 44 percent. On the other hand, new home sales declined by a surprising 11.3 percent in November. This disparity may be explained by the fact that new homes tend to be more expensive than existing homes.

The Federal Open Market Committee (FOMC) met on December 15 and, as expected, kept the fed funds target rate in the zero to 0.25 percent range. The Committee noted that the recovery is continuing and that it will allow some of the special liquidity facilities set up in 2008 and 2009 to expire in 2010 as scheduled. The Committee also noted that inflation remains subdued.

Sector Review

U.S. Treasuries: The treasury market experienced quite a reversal from November as yields rose across the board and finished what was one of the worst years on record for Treasury returns. Better than expected economic readings across the board helped stocks rally and gave investors a reason to shun Treasuries as most investment professionals were pleased to bring 2009 to a close. The 10-year note yield increased to a 3.84 percent yield from a 3.20 percent yield over the prior month. The two-year note yield increased to a 1.14 percent yield from a 0.66 percent yield while the three-month bill saw yields remain steady at 0.04 percent. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase).

Commercial Paper: Commercial paper supply has stabilized recently and yields remain low as the Fed continues to maintain its fed funds target rate in the zero to 0.25 percent range. Money market fund balances remain robust even with unusually low yields. The SEC has still not officially ruled on the adjustments expected to be applied to Rule 2(a)-7, which governs Money Market Funds. One-month and three-month top-tier higher quality asset-backed commercial paper (ABCP) and bank names trade between 0.10 percent and 0.40 percent.

U.S. Government Agencies: The Treasury announced it was going to eliminate the $200 Billion cap on the amount of preferred stock it could invest in Fannie Mae and Freddie Mac. A combined $110 Billion has been purchased of this stock by the Treasury in each. This was another signal that the Treasury is willing to stand behind these entities to help them maintain a strong capital position. The Treasury also relaxed a requirement they placed upon each agency of expecting them to reduce their retained portfolios by 10 percent each year. Agency yields at month-end on three-month paper yielded near 0.06 percent, six-month paper yielded 0.18 percent, and 12-month paper yielded 0.40 percent.

Strategy: The Federal Reserve continues to maintain its federal funds target range between zero and 0.25 percent. The direction of monetary policy in 2010 is a hotly debated topic and non-traditional monetary policies are likely going to be part of the picture along with typical fed funds rate adjustments. It remains a uniquely challenging environment. Our strategy is to remain defensive to interest rates while selectively adding to approved commercial paper issuers.

DJIA		NASDAQ		S&P 500	
0.80%	18.81%	5.80%	43.88%	1.77%	23.45%
Month	Year-to-Date	Month	Year-to-Date	Month	Year-to-Date

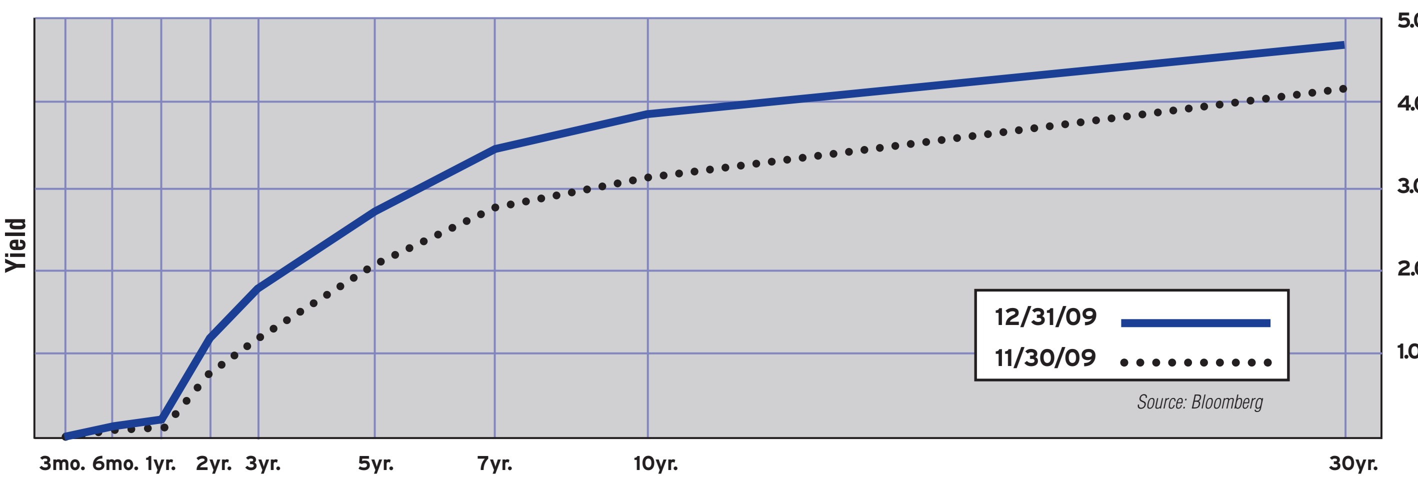
The opinions expressed above are those of TrustINdiana and are subject to change without notice. All statistics represent month-end figures unless otherwise noted.

Market Summary for **December 2009**

Monthly Market Summary - Week-ending Rates and Yields

	12/04	12/11	12/18	12/24	4th QTR AVG	3rd QTR AVG	2nd QTR AVG	1st QTR AVG
Overnight Rates								
Effective Fed Funds	0.12	0.12	0.12	0.11	0.12	0.15	0.18	0.18
Repurchase Agreements	0.07	0.06	0.08	0.03	0.05	0.10	0.14	0.16
Discount Rates								
1 Month Treasury Bill	0.01	0.00	0.00	0.01	0.02	0.10	0.09	0.10
1 Month Agency Disc.	0.06	0.03	0.04	0.04	0.05	0.13	0.13	0.17
1 Month Com'l Paper	0.16	0.16	0.17	0.18	0.18	0.22	0.24	0.36
3 Month Treasury Bill	0.05	0.03	0.04	0.05	0.05	0.14	0.16	0.18
3 Month Agency Disc.	0.07	0.07	0.09	0.10	0.09	0.17	0.19	0.30
3 Month Com'l Paper	0.25	0.19	0.18	0.23	0.25	0.32	0.46	0.71
6 Month Treasury Bill	0.15	0.13	0.13	0.16	0.13	0.22	0.28	0.33
6 Month Agency Disc.	0.16	0.17	0.20	0.21	0.17	0.26	0.30	0.47
6 Month Com'l Paper	0.32	0.22	0.25	0.29	0.32	0.42	0.62	1.04
Yields								
1 Year Treasury	0.36	0.35	0.36	0.43	0.35	0.45	0.53	0.56
1 Year Agency	0.39	0.39	0.41	0.45	0.40	0.52	0.73	0.76
2 Year Treasury	0.83	0.80	0.80	0.97	0.86	1.02	1.02	0.90
2 Year Agency	0.95	0.93	0.92	1.11	0.98	1.16	1.37	1.60
5 Year Treasury	2.24	2.25	2.27	2.54	2.29	2.46	2.25	1.77
5 Year Agency	2.58	2.59	2.61	2.85	2.64	2.87	2.83	2.65

Historical Yield Curve



Key Economic Indicators

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	December	1/8	10.0%	10.0%	10.0%
Consumer Price Index	November	12/16	1.8%	1.8%	-0.2%
- Less Food and Energy	November	12/16	1.8%	1.7%	1.7%
Consumer Conf. (CB)	December	12/29	53.0	52.9	49.5
FOMC Rate Decision		12/16	0%-0.25%	0%-0.25%	0%-0.25%
Gross Domestic Product	3Q	12/22	2.8%	2.2%	2.8%

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